28 September 2022

Board of Taxation Secretariat
The Treasury
Langton Crescent
Parkes ACT 2600

Via Email: TaxDigitalAssets@taxboard.gov.au

Dear Board of Tax members

Re: Review of the Tax Treatment of Digital Assets and Transactions in Australia

Koinly welcomes the opportunity to provide our submission to the Board of Tax (Board) in respect of its review of the tax treatment of digital assets and transactions in Australia. Koinly also thanks the Board for allowing us to contribute to consultation meetings held prior to this submission.

Our submission focuses on the perspective of our software users, who mainly include retail crypto investors and taxation professionals. We are at a crucial point in the industry where current action on digital asset regulation will set the foundations for Australia's future crypto asset industry. We believe Australia has a huge opportunity in this regard and support the Board's review.

Our responses to the questions raised in the Consultation Guide are outlined in the Appendix below. Thanks to Liam Thomson and Rowan Prosser at Koinly for their input in relation to this submission.

Yours Sincerely

Danny Talwar

Head of Tax

Appendix 1

1. **Consultation question 1: Is the current tax treatment of crypto assets clear and understood under the Australian tax law? If not, what are the areas of uncertainty that may require clarification?**

ATO guidance in relation to crypto assets first appeared with regard to Bitcoin in the form of 2014 Taxation Determinations (TD), including:

- **TD 2014/25**: *Income tax: is bitcoin a 'foreign currency' for the purposes of Division 775 of the Income Tax Assessment Act 1997?*
- **TD 2014/26:** *Income tax: is bitcoin a 'CGT asset' for the purposes of subsection 108-5(1) of the Income Tax Assessment Act 1997?*

Taxation Determinations are short form public ruling of the ATO's interpretation of how the Australian law should apply. Whilst the opinions outlined in a Taxation Determination are binding on the ATO in the court of law, they are not legally binding on the taxpayer. To date, there is no legislation concerning the taxation treatment of crypto assets.

The 2014 TDs were followed by more general explanatory guidance on Bitcoin transactions first published by the ATO in 2018 (QC 42159). Since this guidance was first published, the crypto asset industry has changed significantly, with a total market capitalisation of US $130Bn in December 2018 to over US $3 trillion during the 2021 market peak. Whilst Bitcoin remains the dominant crypto asset by market capitalisation, the way in which individuals, institutions and governments interact with and use crypto assets has changed significantly.

The ATO subsequently revised its approach to no longer use Bitcoin as the basis of its crypto asset guidance but to recognise the various forms, including:

- Cryptocurrency (e.g. Bitcoin)
- Stablecoins (e.g. USD Tether)
- Investment tokens
- Game Tokens (e.g. GALA)
- Non-Fungible Tokens (NFTs)

Whilst the industry has differing views on which categories exist, the key message of recognising a variety of crypto assets is welcomed.

There are numerous platforms across the DeFi and GameFi spaces. Uniswap, one of the more prominent Automated Market Makers (AMM), has seen over US$1 trillion in volume since inception and has approximately 4 million users. Similarly, prominent GameFi platform Axie Infinity peaked at 2.8 million monthly active users in late 2021. With high crypto asset adoption in Australia, it can be reasonably assumed that many thousands of Australian taxpayers have used or are regular users of these platforms.

There remains a significant level of uncertainty about the tax treatment of crypto assets for retail investors, organisations and tax agents. It is apparent that from a retail perspective, there are an increasing number of Australians who engage with complex Crypto protocols such as Decentralised Finance (DeFi) or games (GameFi) who are seemingly unaware of the resulting tax implications.

Prima facie, there is a blanket crypto asset taxation approach within the ATO Guidance which leads to tax outcomes that do not always reflect economic reality or perceived user experiences when interacting with crypto assets. Whilst simplification is important to facilitate compliance, the advancement of crypto asset adoption causes numerous challenges. The key areas of uncertainty are listed below and explained with examples of protocols provided where relevant.

1.1. Categories of crypto assets

The current ATO definition of crypto assets is broad, resulting in a range of crypto assets with an array of use cases categorised under the same tax treatment with numerous CGT events for Australian tax resident investors. Currently, there lacks a flexible framework or rule-set for tax practitioners to identify holistic interactions within the crypto asset ecosystem rather than determining the treatment on a transaction-by-transaction basis.

The ATO guidance states that “the most common use of crypto assets is as an investment”. Whilst this predominantly applies, there are increasing utilities and reasons to hold crypto assets outside of investment purposes. The tax treatment of non-investment crypto holdings requires further consideration, particularly concerning personal use assets and hobbies, which is explained in more detail in this submission.

1.2. Staking

The current ATO guidance for staking focuses on the vanilla example where a user locks existing tokens to “validate transactions on the blockchain and create new blocks”. The revenue-based tax treatment of staking income is generally accepted as a valid means to tax income-generating returns. However, it is noted that the term “staking” is also associated with various yield-generating activities where a participant locks a portion of their tokens in return for future rewards. We note that clarification is required to define staking from an ATO perspective in order to apply a particular tax treatment. In particular, the clarification should include differentiation between staking to validate transactions on a blockchain compared to lending or yield rewards.

Some issues lie in certain protocols and applications which are akin to staking and still offer the ability to generate passive income but offer challenges in identifying appropriate taxing points, which are substantially different to traditional staking for blockchain validation purposes.

1.3. Timing

In some protocols, it can be challenging to understand the correct taxing point from a timing perspective. For example, prior to the transition of the Ethereum network from Proof of Work to Proof of Stake, ETH holders can stake funds through a range of methods, including via centralised or decentralised protocols. Often, staking rewards will accrue in the holder's account; however, an ETH staker will only be able to withdraw their funds once an upgrade (referred to as "sharding") has been completed.

An example of a timing issue can be seen in Exodus protocol - a non-custodial crypto wallet allowing users to stake into a pool within the application. Users who stake Solana (SOL) within the protocol will have staking rewards automatically added to their existing staked balance (also referred to as "auto-compounding"). In such instances, it can be challenging to identify the market value at the point in which staking rewards were derived.

By contrast, Exodus users who wish to stake ATOM can choose when to claim their staking reward, which does not auto-compound. Timing clarification is required as to whether income is derived at the point they are eligible to claim their reward or when they make a claim.

1.4. Deferred gain

It can be argued that the concept of staking should not incur income tax in respect of additional tokens received by virtue of those tokens being property that is created through validating transactions in the network[1].

A common area of confusion for investors surrounds the lack of ability to offset capital losses on income generated through staking activities, particularly when staking is required to create additional assets of a capital nature. Current market conditions have led to the widespread misunderstanding that capital losses can be used to offset staking income.

1.5. Method of staking

There are various methods in which staking can apply:

- **Solo staking**: a direct form of staking which involves staking funds to become a validator on the blockchain
- **Centralised staking:** a staking pool run by a centralised entity such as an exchange or smart contract (which can involve receiving a "staked ETH" token, such as Lido's stETH token

Tax complexity is added when third-party applications such as those outlined above facilitate the staking process. Staking via centralised pools often lowers the

[1] It is noted there is an ongoing case in the United States (Jarrett et al v. United States) with the taxpayer seeking certainty on future tax treatment of this matter.

barrier to entry for stakers[2] as the minimum requirements to stake may be financially unattainable for some retail investors.

Clarification is required as to whether there is a different tax treatment by staking through a centralised staking pool in comparison to direct staking. In particular, it is noted that staking through a centralised pool carries a higher risk than direct staking due to a third-party centralised staking pool effectively taking custody over staked funds. At this point, in absence of clear guidance, an analysis is required to determine a change in beneficial ownership at the protocol level, which in most instances will attract onerous compliance requirements.

1.6. DeFi - providing liquidity

An increasing number of crypto holders opt to deposit funds as pairs in DeFi liquidity pools in order to earn a share of the trading fees obtained through the protocol. A liquidity provider (LP) token represents the pooled funds and is often provided in exchange for the provision of liquidity.

When a token pair is deposited, the ATO has referred to a CGT event[3] occurring and a change in the beneficial ownership. In this instance, it may be logical that a change in beneficial ownership occurs from a tax perspective, particularly as the LP token received carries different rights and obligations to the deposited assets[4]. From a retail perspective, however, this needs to be further clarified.

It is noted that there is no formal guidance or law in relation to DeFi. It is important for these aspects to be addressed, particularly as many retail users are unaware of the CGT event when providing liquidity due to the value associated with their LP tokens.

1.7. DeFi - lending and borrowing

The Total Value Locked (TVL) in DeFi protocols peaked at just over US$180bn[5] during late 2021. Lenders are incentivised by returns offered by DeFi protocols in comparison to traditional financial alternatives, while borrowers are incentivised by the ability to borrow against their digital assets.

DeFi platforms benefit crypto asset holders by opening up traditional avenues of borrowing, lending, collateralisation and leverage from the conventional financial system in a peer-to-peer fashion. While questions from regulators remain over the ease by which users can earn interest and borrow against their crypto assets with little-to-no KYC or authentification, the DeFi space continues to be innovative. It serves crypto participants with platforms and products in a way that traditional financial providers have not.

Sections 1.7.1 and 1.7.2 outline tax considerations of two prominent DeFi platforms by TVL and users, MakerDAO and AAVE, respectively.

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[2] Ethereum direct staking requires a minimum of 32ETH.
[3] ATO Community Guidance [https://community.ato.gov.au/s/question/a0J9s0000003bSY/p00174058]
[4] The Value of LP tokens is not equivalent to the value of deposited tokens in the pool.
[5] Source: DeFi Lama

1.7.1. MakerDAO

MakerDAO is a DeFi protocol that runs on the Ethereum blockchain (as well as other Layer 2 blockchains such as Polygon, Avalanche, Optimism, and Arbitrum).

These DeFi platforms allow lenders to provide crypto collateral (e.g. ETH) in return for stablecoin proceeds (such as DAI, USD, or USDT). In doing so, the borrower undertakes the following bundle of transactions:

- Deposits ERC-20 token as collateral (e.g. ETH)
- ETH is wrapped to WETH to enable ERC-20 token capability
- WETH is deposited on the protocol smart contract and held in escrow. The asset is collateral for loan proceeds paid in a stablecoin (e.g. DAI), a decentralised stablecoin that pegs[6] to USD. This is referred to as a Collateralised Debt Position (CDP). The value of the collateral deposited must always exceed the value of the DAI borrowed (e.g. 150%).
- Borrowed DAI is returned, and ETH collateral is released.

Under current ATO guidance, coin-to-coin transactions are taxable events. However, on closer inspection of the MakerDAO protocol, the above scenario does not appear to demonstrate a change in beneficial ownership. Parallels can be drawn from mortgaging property or securities lending transactions where CGT events are not triggered if beneficial ownership of the collateral is retained. There are examples where legal and economic ownership of assets can be split without leading to a CGT event (e.g. renting an investment property). If a borrower cannot service the loan, the terms of the smart contract allow the protocol to seize the collateral, at which point a CGT event may occur.

Clarification is required to confirm that a protocol holding funds in escrow is not a CGT event unless a liquidation occurs. It is also important to note that the aforementioned transaction steps should be considered on a holistic basis rather than a transaction-by-transaction approach the ATO currently takes. This is also because a person interacting with the MakerDAO protocol will see their interactions as a bundle of actions to achieve an intended outcome (i.e. to borrow DAI stablecoin).

1.7.2. AAVE

Aave is another prominent DeFi protocol that runs on the Ethereum blockchain. In borrowing funds on the Aave protocol, the following bundle of transactions occurs:

- User deposits ETH collateral
- User's ETH is 'wrapped' to WETH (Wrapped ETH)

[6] DAI is 'soft-pegged' to USD and over-collateralized by crypto assets deposited by the platform lenders.

- User receives a tokenised version of their WETH collateral (aETH) reflecting the underlying WETH deposited
- aETH held on the AAVE platform now allows the token holder to accrue interest on their deposited WETH
- aETH simultaneously acts as collateral whereby a depositor can borrow against it
- aETH is returned in exchange for WETH plus interest accrued while deposited

The above scenario reflects the depositors' rights to receive ETH when aETH is returned. Protocols where a receipt token is generated and funds are not held in escrow calls beneficial ownership into question (in comparison to the MakerDAO example above). A key issue is the experience for investors in both instances is similar. As such, it is impractical to undertake a protocol-by-protocol analysis to determine if a disposal occurs.

Additionally, there is a similar user interface of all DeFi lending platforms, leading to issues for accountants in determining on current lack of guidance on whether a CGT event has occurred. Clarification is required in this regard, notwithstanding that a protocol-by-protocol analysis would be overly onerous for most retail investors. As such, guidance is needed on categorisations of lending activities likely to trigger CGT events.

1.8. Bridging and wrapping

A wrapped token is a tokenised version of another crypto asset in order for it to be used on non-native blockchains (e.g. wrapped Bitcoin, which can be transacted on the Ethereum blockchain). The ATO Guidance refers to a CGT event when exchanging one crypto asset for another. In the context of a Wrapped ETH (WETH) to interact with decentralised applications on the Ethereum blockchain[7], the ATO also comment on this through their Community Guidance[8] as leading to a CGT event.

Wrapped tokens, like WETH, broaden users' opportunities in the crypto space to interact with DeFi platforms, Decentralised Exchanges (DEXs) and buying and selling NFTs on platforms such as Opensea. At a smart contract level, wrapped tokens are cheaper regarding gas fees and have far more liquidity on DEXs and DeFi.

The concept of wrapping calls into question whether a change in beneficial ownership has occurred - it is difficult to accept that the process of wrapping causes changes in beneficial ownership through a change in underlying features of ERC-20 token standard[9].

[7] The ETH token was created prior to ERC-20 token standard which allows creation and recording of fungible tokens
[8] ATO Community Guidance [https://community.ato.gov.au/s/question/a0J9s0000001IHj/p00046589]
[9] Token standards can be viewed as crypto asset development ruleset for use on different blockchain protocols.

It is noted that CGT triggers in respect of bridging and wrapping have caused concern for retail investors, where numerous taxable events may occur. Wrapped tokens can be used to interact with decentralised applications in a cheaper manner due to smart contract upgrades on the Ethereum mainnet and other 'Layer 2' protocols.

1.9. Reflection tokens

Reflection tokens incentivise incumbent holders of a particular token through a fee (or tax) on each transaction. The tax treatment of Safemoon, a reflection token, is a common query received by Koinly's customer support team.

The token charges a 10% fee on each transaction where a holder sells any of their tokens (of which a 5% 'reflection' is distributed to existing token holders). As a result, an investor's holding frequently changes without the ability to reasonably track the value at a particular point in time.

Clarification is required regarding whether the token reflections are treated as zero-cost base CGT assets for investors.

1.10. Airdrops

Airdrops is a term referred to events where users of certain digital protocols are rewarded for their use via tokens that often hold financial value.

Prior to a recent ATO update, airdrops were taxable as ordinary income at market value when derived which created much confusion particularly as airdrops are generally unsolicited events.

In September 2022, the ATO updated its guidance on the tax treatment of "Initial Allocation Airdrops" - a term referred to as the first distribution of a crypto project's tokens. Such airdrops are no longer taxed when received and are treated as having zero cost base, thus taxable on disposal for investors. Whilst the update is a welcome step to clarifying that unsolicited airdropped tokens generally do not get taxed as income when received (since most airdrops satisfy the initial allocation airdrop term), the term "initial allocation airdrops" is confusing since most airdrops are initial allocations. Arguably, established tokens received are akin to staking income or other rewards taxed on a revenue basis.

1.11. Governance tokens

Governance tokens incentivise the purchase and accumulation of cryptocurrency in order to have voting rights in the token ecosystem. In general, the more governance tokens you accumulate, the more voting rights are attributable to a token holder. While there is a degree of speculation across governance tokens, many allow those holding the tokens to vote on the future of the platform or ecosystem they represent. By definition, governance tokens are intended to be held and used for voting on proposals - which has been successfully done across many DeFi protocols, including Uniswap and Optimism. From a tax perspective,

there is no clear treatment or classification of governance tokens leading to confusion as to the tax treatment amongst retail investors.

1.12. Blockchain-based games (Game-Fi)

Blockchain-based games (Game-Fi) such as Axie Infinity, where users can acquire and build NFT collections in a gaming environment, often have perceived tax consequences that are unclear. Whilst a more detailed example of Game Fi is provided in response to question 2, it should be noted that there are various reasons and intentions for playing games that can affect the tax treatment. For example, gamers may play as a hobby, to earn income, in-game status (or "bragging rights"), or to run an NFT trading business. Currently, there is limited guidance in identifying each type of gamer.

Further, gamers who play for enjoyment or in-game status may never materialise the value of their in-game holdings in AUD. Based on the inference of current guidance on crypto-to-crypto transactions being disposal events and NFT staking generating income, gamers accumulate extremely high transaction volumes, which can be near impossible to record in the absence of software. As such, there is a need for clearer guidance to identify tax obligations arising from gaming and allow for a simplification of compliance obligations, particularly for gamers who wish to remain within their in-game ecosystem (e.g. for hobby or in-game status).

1.13. NFTs

NFTs (Non-Fungible Tokens) have an array of use cases, including proof of ownership, on-chain artwork, ticketing, music and gaming, highlighting the need for a categorisation exercise to determine more specific tax treatments of crypto assets such as NFT based on their intended use cases for the owner.

Prominent examples of NFTs are Profile Picture (PFP) projects which traditionally have a fixed supply of 10,000 units. A prominent example is the Bored Ape Yacht Club (BAYC), which launched in May 2021. While price speculation became a notable feature of NFT market participants, initial purchases of many projects were at substantially lower prices than the prevailing (e.g. BAYC NFTs were initially sold for 0.08ETH - or A$500 and rose to highs of over A$600,000 in May 2022).

Commonly, NFT art is transacted via marketplaces such as Opensea, which for an investor, is treated on capital account. Current ATO guidance does not consider whether NFTs can be classified as collectibles or as a hobby. More complex questions arise with fractionalised NFTs, NFT staking, royalties attributable to NFT creators and in-game NFT trades.

1.14. Investor v trader

Crypto assets transactions can occur in seconds through digital exchanges, often at the click of a button. It is not uncommon for a casual investor to have tens of thousands of crypto transactions in a given income year which can lead to confusion over whether a person is carrying on a business, an individual investor

subject to CGT or an individual investor with a profit-making intention treated on revenue account.

The unique way people interact and transact with crypto (particularly when resulting in high trading volumes) requires a more detailed consideration of how the tax classification as an investor or trader applies. Further clarification is required concerning the threshold of profit-making intention and transactions with a commercial undertaking despite existing case law which is not crypto-specific (e.g. Myer Emporium and Greig).

1.15. Personal Use Asset rule

There is confusion over the application of the personal use asset rule for both retail investors and accountants. Misunderstanding predominantly stems from the personal use of existing crypto assets which are held for a period of time. Whilst current guidance suggests the personal use asset rule is rarely applicable, the spending of crypto assets for personal use should be clarified. In most cases, crypto spending transactions lead to a taxable event that causes compliance issues, particularly when facilitated through crypto-linked spending cards.

Clarification is required as to how the rule applies with a view to simplifying the personal use asset rule. This is required when an individual purchases personal items or purchases of crypto assets as a hobby.

2. Consultation question 2: Do crypto assets and associated transactions feature particular characteristics that are 'incompatible' with current tax laws? If yes, what are these and why are they incompatible?

Acknowledging that existing tax regimes should apply where practicable, it is apparent that some crypto assets are incompatible with existing frameworks, and how the crypto ecosystem interacts is materially different to other assets or technology.

The Final Report from the Select Committee on Australia as a Technology and Financial Centre recommended that a CGT event is created only where there is a definable capital gain or loss. The current features of crypto assets incompatible with the tax outcome predominantly relate to the number of CGT and income-generating events created by just interacting within the Crypto ecosystem - whether it be DeFi, gaming or NFTs. Whilst many retail investors are unaware of the tax treatment of engaging in crypto assets, more sophisticated investors are put off by the number of taxable events, which is likely to stifle innovation in this space.

Crypto assets must be considered as part of a broader ecosystem or economy rather than transaction-by-transaction taxation, which the current ATO guidance suggests. Whilst this matches the economic reality in how many interact with more complex areas of crypto and blockchain technologies, this will become increasingly more relevant as metaverse concepts develop. Under the framework of current guidance, interactions and crypto trading create an unrealistic amount of taxable events which doesn't align with economic outcomes.

Below are two expanded examples of how economic interactions and user experiences do not align with the current tax treatment.

2.1. Blockchain-based gaming

GameFi has quickly become a significant driver of new crypto adopters worldwide. The majority of GameFi games that have been released follow a similar formula. Investors buy a gaming NFT (character) and use that character to earn crypto assets in-game. The crypto assets earned are often used as a cost to breed the NFT with another NFT character to create an egg that will hatch into a new character over time. As these characters breed, they move toward a breeding cap, which depreciates their value. There are numerous occurrences of NFTs as a result of breeding alone - for example, NFT characters can be retained or burned to create new NFTs. Each of these actions, based on current interpretation, could be taxable events (e.g. disposing of in-game tokens in order to create a new NFT).

Another common theme within GameFi is scholarships. This is where investors loan crypto assets to individuals who are able to use their NFTs to generate additional crypto. In this model, new assets are split between the owner and the

player. In this method, both the owner and the renter create hundreds of potential income-generating taxable events (noting that such activities may be akin to running a business). It should be noted that every game is different in the way they generate play-to-earn style rewards.

The way in which GameFi economies are developing is new and distinctly different to existing games. In addition, there are a number of gamers under the age of 18, leaving parents concerned as to their child's tax obligations if significant income arises from their in-game activities.

As GameFi projects seek to build full-service DeFi ecosystems, current guidance could lead to a CGT or income-generating event whenever the native game currencies are exchanged for fiat or a non-native currency such as Ethereum. Such treatment would again lead to numerous taxable events. Alternatively, a taxing point may also occur when the native currency is bridged out of the ecosystem to a layer one or exchange.

The overarching result of the above example is that the current tax treatment leads to unrealistic outcomes, particularly when many gamers play for recreational purposes. It is possible that GameFi activities could generate hundreds of taxable events for which records must be kept. Clear guidance must be provided to distinguish between hobby gamers, play-to-earn gamers who intend to earn income and gamers who may transition from hobby gaming to incurring income tax obligations.

2.2. DAOs

Decentralised Autonomous Organisations (DAOs) have risen to prominence over the past few years. DAOs allow a limited (or unlimited) number of participants to form a decentralised organisation with participants spanning multiple countries and tax regimes, usually with a common goal or intention. The legal and tax uncertainty of DAOs creates a barrier to investment and innovation when a technology-neutral outcome is needed.

In a similar way to governance tokens, DAOs allow holders of an underlying token or NFT to raise capital. Token holders are eligible to vote on proposals, informing how or what the DAO will use funds for.

For example, several high-profile use cases of the DAO structure being used recently have been attempting to acquire the US Declaration of Independence (ConstitutionDAO), purchasing NFT and digital art (FlamingoDAO), and a combination of acquiring traditional art and music pieces, in addition to NFT and digital art (pleasrDAO). DAO participants are often unaware of tax repercussions, particularly due to the "hive mind" nature of quickly leveraging smart contracts in order to raise capital for a collective goal in the same way (and with the same

ease) that a crowdfund effort may have in setting up a donation drive on a centralised platform.

Participants of DAO often change daily due to the ability for DAO "memberships" to be traded via digital tokens or NFTs. This raises the question of what a DAO is. While many DAOs have a flat holding and governance structure (e.g. 1 token = 1 vote), others have a tiered approach (e.g. bronze, silver, gold) which can complicate the ownership structure of a DAO between token holders.

The tax treatment of DAOs is unclear, stemming from uncertainty as to its legal characterisation. A DAO fundamentally differs from existing partnerships or companies in the decentralised way they operate. DAOs do not neatly fit into an existing company or partnership structure, and doing so creates outcomes that are not reflective of the economic functions and operations of a DAO.

For example, a partnership model places a burden on DAO governance token holders if treated akin to partnerships. However, if the governance token is openly traded on a public marketplace, taxation at the token holder level would create a mismatch between where economic value is created (which may even be through smart contracts) and who is taxed.

Similarly, DAOs taxed at the entity level would raise challenges in regards to management and control, source and tax nexus across jurisdictions, particularly as DAOs facilitate borderless collaboration. The identification of the DAO value chain becomes increasingly difficult and onerous as technology advances.

3. Consultation question 4: Are retail investors aware of the current tax treatment of crypto assets? To what extent are they receiving professional tax advice?

3.1. Retail awareness

Koinly contributes to educational events, podcasts, webinars and content to enhance awareness of crypto asset taxation for retail investors. Retail crypto asset investors generally have a low awareness of their specific tax obligations. Whilst the majority of crypto asset holders understand they have tax responsibilities associated with owning crypto, in our experience and for the issues identified in the sections above, there is limited retail awareness of specific tax treatments. Under third-party research commissioned by Koinly, encouragingly, 85% of crypto investors were aware that crypto assets are taxable - this aligns with our experiences that the vast majority of investors seek to comply in good faith.

In the absence of clear guidance addressing the nuanced issues identified in this and other submissions, crypto asset holders face a significant risk of unintentional non-compliance with ATO guidance.

Often, the following areas are unclear for retail crypto asset investors and represent common misconceptions:

- **Record keeping:** There is limited understanding of what threshold level of information is required to be retained
- **Staking:** Taxation of staking rewards as income despite the token treated under capital account
- **Crypto spending cards:** The number of crypto-related spending cards has increased recently, with many retail investors using crypto debit cards linked to their investment portfolios. Investors are unaware of the taxable disposal events they create through spending, the application of the Personal Use Asset rule and any associated crypto rewards they may earn. Insights can also be drawn from research commissioned in the UK by HM Revenue and Customs (HMRC)[10], which found that only 42% of crypto owners were aware that they might be liable to pay tax when purchasing goods and services using cryptocurrency.
- **Hobby Gaming:** Taxable implications from play-to-earn blockchain games
- **Capital losses:** With recent bankruptcies of centralised passive income platforms (e.g. Celsisus), retail investors are concerned as to when they can claim any associated losses whilst their funds cannot be realised during Chapter 11 proceedings
- **Investor or trader:** In the context of crypto trading, it is unclear for individuals to distinguish between these concepts. Many are misunderstood in thinking they can make an election in this regard. Current ATO guidance is limited to the context of "share investing versus share trading".
- **Small balances: transaction fees and "dust" in exchanges:** A common feature of crypto asset trading is the resultant small residual balances, often referred to as "dust". Exchanges often allow for dust balances to be rolled into one crypto asset or into fiat currency (like AUD). However, dust is usually fractions of a cent as a residual balance following a crypto swap or sale due to the nature of exchanges or protocols rounding up/down to the nearest decimal and leaving a small balance. For taxation purposes, these balances can lead to confusion for crypto investors.

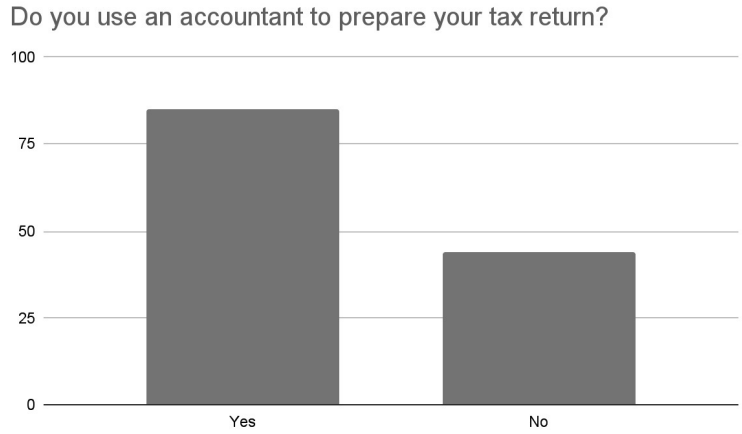
Whilst it is recognised that the ATO has updated their website guidance to accommodate retail investors, there is a lack of specificity in the guidance, particularly addressing an individual's circumstance as a trader or individual investor. Unsurprisingly, many crypto holders are frustrated at the lack of guidance available on a protocol or crypto-asset category level.

[10] "Individuals holding cryptoassets: uptake and understanding", Kantar Public, 2022, n=459

The ATO community guidance is a relevant source of information for retail investors who seek clarification on specific matters. Where ATO guidance is limited, retail investors seeking answers via google search are often presented with ATO community guidance forums. From a retail investor's perspective, it would be reasonable to assume that some reliance is placed on the ATO responses provided to queries. In our experience, the community guidance is contradictory and often opines on queries without due consideration of the facts and circumstances. One particular response opines on individual trading as a business in the absence of trading volume and clear facts and circumstances: *"You're not going to be a investor if you're performing so many transactions - you'll be a trader. This means you work on business income rules instead."*

3.2. Professional advice

Koinly surveyed retail crypto investors on whether they use an accountant to file their tax returns[11].



Whilst the majority of respondents use an accountant to prepare their income tax returns, there is a discrepancy between the demand for compliance services and bespoke tax advice. It is apparent that a significant proportion of retail investors do not seek bespoke tax advice in respect of their crypto holdings. Many cite issues with finding accountants who understand the technicalities of crypto assets, particularly where individuals run business-like operations in addition to their full-time job.

A factor that may contribute to this is the significant portion of young crypto holders who may not be accustomed to paying for taxation advice on their investments in comparison to experienced investors with a clear investment strategy. A Koinly survey found that 54% of crypto investors were aged between 18-44. This is substantiated by a large research study commissioned by Roy Morgan, which found that 59% of crypto investors were aged between 18-34[12].

[11] Source: Koinly Survey, September 2022, n=129
[12] Source: Roy Morgan Single Source, December 2021 – February 2022, n=15,989.

4. Consultation question 6: How can taxpayer awareness of the tax treatment of crypto assets be improved?

Awareness of the tax treatment of crypto assets should be built on having clear Australian tax law and more detailed ATO guidance to reflect the way crypto asset holders transact.

The following factors are ways in which the ATO can increase awareness for retail investors:

- **ATO event presence:** Increased event presence by the ATO in relation to crypto assets and accounting-specific events. Whilst many exist, these events often have limited representation from the ATO. Webinar appearances are also often a great source of education for retail investors.
- **ATO guidance examples:** More detailed examples to cater for investor scenarios would increase awareness of different tax treatment for crypto asset transactions (e.g. whether the ATO view a swap from ETH - wETH as a taxable event, given most investors view these as the same asset).
- **ATO community education:** Collaboration between ATO and communities involved in crypto is important. Often, companies within the crypto space, including exchanges, have a large following of crypto holders or hobbyists.
- **Tax education on exchanges:** Fiat to crypto on-ramps are often seamless and, as such, presents a low barrier to entry to the crypto markets. Exchanges in recent times have increased the level of tax education, which is often of high value to crypto holders. However, exchanges are limited by the lack of current available ATO guidance. Many investors are interested to hear about the ATO Data Matching Program with Australian Exchanges.

The awareness of tax treatments can also be linked to ATO community forums in respect of specific protocols or examples that people have queries about. Currently, these forums contain numerous inconsistencies, as noted in question 4. Awareness would be improved with more detailed information and formal guidance to reduce confusion on specific scenarios.

5. Consultation question 7: How should the tax transparency of crypto assets be improved, including what information tax administrations need to know about transactions for purposes of compliance and enforcement?

The Organisation of Economic Cooperation and Development (OECD) is developing a detailed transparency framework in respect of crypto asset reporting (CARF). The following four types of transactions are reportable under the CARF:

- Exchanges between crypto assets and fiat
- Exchanges between one or more forms of crypto asset
- Reportable retail transactions
- Transfers of crypto assets

It is important that Australia maintains competitiveness on an international scale through consistent reporting requirements. Imposing additional requirements over and above or in lieu of those to be recommended by OECD's CARF may create onerous or duplicative reporting obligations.

Consideration must be given to how technology can be used to better drive tax transparency to eliminate multiple reporting requirements where existing information can be obtained by virtue of blockchain technology which is inherently traceable.

6. Consultation question 8: What lessons can Australia draw from the taxation of crypto assets in other comparable jurisdictions, including novel ways of taxing these transactions?

The following explores novel tax treatments of specific crypto assets. The key learnings of these examples are:

- Tax treatment must reflect economic reality
- Tax certainty and concessional treatments drive proactive economic policy to encourage innovation

6.1. United Kingdom - DeFi activities

The UK was one of the first jurisdictions to release guidance on the tax treatment of DeFi activities. However, concern was raised as to the number of taxable events that can be created through DeFi (many of which are raised in earlier sections of this submission). Subsequently, HMRC opened a consultation for the tax treatment of DeFi lending and staking activities under which the following three options were presented:

- **Option 1 -** Legislate to bring DeFi lending and staking within the Repo and Stock Lending rules by defining crypto assets as 'securities'
- **Option 2 -** Legislate to create separate rules for DeFi lending and staking, along the lines of those applicable to repos and stock lending
- **Option 3** - Apply a 'no loss, no gain' treatment to DeFi loans and staking, deferring the tax liability until the assets are economically disposed of

Australia can draw upon the outcome of this consultation process to consider its own approach to the taxation of DeFi activities. Encouragingly, HMRC outlined that "the tax system ought to reflect the economic substance of the activity in question", acknowledging that the current treatment of disposable events for staking and lending may lead "some stakeholders to question whether the tax treatment is consistent with the economic substance of the transaction".

It is considered that Option 3 is favourable to reflect the economic reality and substance of DeFi transactions to eliminate a dry tax charge.

6.2. Germany

In 2022, the German Federal Ministry of Finance (BMF) released guidance aligning with its strategy to harness blockchain technology and make it an attractive hub for the development and innovation of crypto assets and blockchain-based companies. Under the BMF guidance, crypto assets sold by investors are tax exempt if held for more than one year or if under EUR 600 per annum.

6.3. United States - DAOs

Decentralised Autonomous Organisations (DAOs) are increasingly prevalent as a result of their transparent and decentralised structures, which promote trustless collaboration.

The US state of Wyoming has formally recognised DAOs as a form of limited liability corporation (DAO LLC). The appropriate legal recognition of DAOs is an important step to understanding the flow-on tax characterisation of a DAO.

7. Consultation question 9: What changes, if any, should be made to Australia's taxation laws in relation to crypto assets, whilst maintaining the integrity of the tax system? If changes are required, please specify the reasons.

Suggestions on changes to Australian tax law are already included in earlier parts of this submission; however, some additional considerations are included below.

7.1. Blockchain-based gaming:

The introduction of concessional CGT and income tax treatment for hobby gamers should be considered - particularly in regard to minors under the age of 18. Clarification is sought on the timing of taxable events for play-to-earn games that derive income from gaming with the intention to convert in-game earnings into fiat currency such as AUD. In the latter example, the taxing point should be deferred until a fiat/stablecoin value is realised or an individual is able to transact in fiat/stablecoin equivalent outside of the game economy. In the absence of the above approaches and in conjunction with the lack of tax education provided to gamers (who are often under 30), individuals are required to set funds aside to pay their tax bills due to dry tax charges. Whilst, in many cases, this is a realistic outcome (i.e. the ATO will not accept crypto payments), it presents a mismatch with economic circumstances, as highlighted in the in-game economy considerations in question 2.

7.2. DAOs

When considering appropriate legal and tax frameworks, there should be due consideration to the future economic benefits through innovations created by DAOs. This will likely not be achieved through existing corporations law, and separate legal entities or frameworks should be considered to accommodate DAOs. Tax implications can only be considered following appropriate legal characterisation.

7.3. Early tokens distributed to founders

Early contributors to projects within the crypto ecosystem are typically rewarded with early token issuances in the hope of project success. Australian start-ups may benefit from concessional tax treatments under Employee Share Scheme (ESS). There is currently no extension of ESS concessions for crypto assets despite the similarities to shares being CGT assets.

It would be a proactive measure to implement similar concessions to ESS for founders and early project contributors in order to maintain competitiveness.

8. **Consultation question 10: How could tax laws be designed to ensure that they keep pace with the rapidly evolving nature of crypto assets?**

As crypto assets and blockchain ecosystems are novel technologies, a definitive list of use cases has not yet been created. For example, Web 3 and Metaverse technologies are in their infancy, with no clear picture to retail investors as to how individuals, corporations and governments will operate within these ecosystems. What is clear, however, is that such technologies are already being tested, used and developed, with capital flows to the crypto asset sector set to increase.

In order to keep pace with the rapidly changing and evolving nature of crypto assets, it is important that policymakers allow for a principle-based approach when designing tax laws to allow sufficient flexibility as technology develops. In particular, consideration must be given to the economic value created by a series of transactions and taxation points occurring only when there is an identifiable economic benefit (income or capital) to the taxpayer. In the absence of clarity and legal characterisations of crypto assets, reliefs should be provided to crypto asset holders and organisations in the industry to allow further innovation and investment to occur without burdensome compliance and legal barriers by virtue of adopting novel technology.

9. **Consultation question 11: How can the existing tax treatment of crypto assets be improved to ensure better compliance and administration?**

A simplification of the existing tax treatment is required for retail investors to allow for taxing points in consideration of a series of transactions with a particular outcome rather than transaction-by-transaction taxing points. This is particularly important for DeFi and GameFi scenarios for the reasons outlined already in this submission.

To ensure better compliance and administration, it is important to be able to identify clear taxing points within ATO guidance and Australian law. A clearer explanation and a clarification of the personal use asset rule to allow crypto holders to spend their assets for personal items will assist in simplifying the current interpretation of the rules and reducing unintentional non-compliance.

10. Consultation question 12: What data sources are available to assist taxpayers in completing their tax obligations and/or the ATO in implementing its compliance activities?

10.1. Koinly - Crypto tax software

Koinly is a software that helps individuals and accountants calculate crypto asset taxes and generate income tax reports specific to Australian ATO guidance (and is adapted to guidance within other jurisdictions). The platform allows users to track their crypto asset portfolio on a real-time basis across multiple exchanges, wallets and blockchains.

Koinly software is often used in conjunction with tax agents who consider the individual tax facts and circumstances relevant to determining an individual or business income tax return. In the absence of software to track crypto asset transactions across multiple wallets, compliance would be burdensome.

In September 2022, the ATO updated its record-keeping guidance to suggest that crypto tax calculators can be used to keep crypto asset records.

10.2. Blockchain explorer tools

Information on public blockchain ledgers can be accessed through blockchain explorer tools such as etherscan.io for the Ethereum blockchain, blockchain.com for the Bitcoin network, and solscan.io for the Solana network. These tools are simple to access via website links and operate as a blockchain search engine using wallet addresses or transaction IDs.

Blockchain explorer tools will provide a detailed insight into a particular blockchain transaction and may be useful records for tax authorities and taxpayers.

10.3. Blockchain analytics software

Software companies such as Chainalysis could assist with identifying criminal activity, including those who seek to intentionally evade taxes in Australia.

10.4. Market price aggregators

Accurate tax reporting requires the identification of a market price which can be a challenge when a particular asset trades at low liquidity levels. Volume-weighted average price aggregators such as Coinmarketcap and Coingecko are useful in understanding a market price in comparison to using one particular exchange.

10.5. Blockchain oracles

Blockchain oracles such as Chainlink and Pyth Network facilitate the processing and interpretation of data between smart contracts and off-chain data. Oracles also play an important role in providing price feeds to decentralised exchanges and price aggregators such as Coinmarketcap and Coingecko.

This data is important to the integrity of prices across DeFi protocols and crypto tax software, as accurate and timely price information is crucial in maintaining a correct snapshot of holdings and valuations at any point in time.

11. **Consultation question 13: Are there intermediaries (such as exchanges) that are involved in particular crypto asset transactions that could play a role in the administration of the tax laws? If so, what would their involvement look like?**

Intermediaries such as Australian exchanges already play a role in compliance and tax administration. The ATO Data Matching Program has been in place since 2014, obligating Australian Designated Service Providers (DSPs) to provide transactional information to the ATO, including purchase and sale information.

Crypto exchanges, as well as crypto tax platforms such as Koinly, currently provide a vast amount of education and financial literacy information to users and non-users of their platforms.

Koinly's blogs and guides are constantly updated based on the latest regulatory guidance, with expert opinions from local tax professionals and answers to the most frequently asked questions from our customer base.

In addition, "Learn to Earn" programs such as those from Coinbase and Binance allow new users to learn about various aspects of the crypto space in reward for small amounts of crypto tokens. Ironically, under the current tax treatment, these small payments (often around A$1) could be CGT assets treated as income when received.

Administration of tax laws can only be effective once clearer guidance and law are implemented. Currently, software such as Koinly builds local tax guidance and law into their platforms to assist with data aggregation, for example, with respect to CGT calculations. Intermediaries such as exchanges often partner with software products to assist crypto holders in managing tax administration.

There is a question as to whether decentralised exchanges such as Uniswap and blockchain wallets such as Metamask can play a role in tax administration. Interactions with decentralised protocols and applications often do not require a know-your-customer (KYC) verification process, although they will not generally allow conversion from crypto to fiat currency. Extension to data matching protocols to include decentralised reporting may be attempted, although this will be difficult to administer in practice and will raise concerns surrounding data privacy.

12. **Consultation question 14: How can taxpayers be further supported to understand their tax obligations in relation to crypto assets?**

In a recent survey of 500 participants, Koinly found that 15% of Australian crypto investors were unaware that crypto was a taxable asset class. 37% of "crypto

considerers" (individuals who are aware of what cryptocurrencies are but have not yet invested) were unaware that crypto was taxable.

This demonstrates that Australian taxpayers broadly understand that there are tax obligations relating to cryptocurrencies. However, for the factors outlined in question 1, there is a significant portion of individual investors who remain unaware of how or why crypto may be taxed. This is particularly relevant in situations where economic reality does not align with current tax treatment.

There is a clear need for categorisation and classification of types of crypto assets and a more nuanced consideration as to how the tax treatment of a particular crypto asset may vary based on intentions, use cases and economic reality.

Education and financial literacy, with a specific focus on crypto asset classes, will be essential as the space continues to grow. Crypto exchanges, crypto tax software providers, accountants and financial advisers currently provide much of this information and are an integral part of the onboarding of many thousands of crypto holders. Much of the information provided recommends crypto holders seek advice from qualified tax professionals. However, there is a tendency for many crypto holders to self-assess and manage their tax affairs often when individuals cannot afford to use advisers as a result of dry tax charge obligations.

The existing tax treatment of crypto assets should be clearly articulated by ATO guidance and implemented into law to provide taxpayers and tax professionals with a level of certainty on income tax return disclosures. Confusion can be avoided through more careful execution of ATO Community Guidance, as highlighted in section 3.

Currently, there is a compliance challenge caused by ATO guidance being updated on a silent basis, for example, with Airdrops on 7 September 2022[13]. As outlined in question 1, the guidance for airdrops changed during tax lodgement season, leaving many taxpayers wondering whether an amended assessment is required. In addition, many taxpayers will still be unaware of the changes, which leads to challenges in compliance and administration.

The ATO and Treasury's role in the creation and distribution of guidance and appropriate law will be vital to taxpayers over the coming years and should ensure measures are taken to engage with the community so as to understand the intricacies of this space. It is hoped that part of this will be achieved through Treasury's token mapping exercise.

13. Consultation question 15: What additional support can be provided to the tax adviser community to assist them in advising their clients in relation to the tax treatment of crypto assets?

Tax advisers face significant challenges in managing clients with crypto assets. With only a fraction of tax advisors specialising in crypto assets, many face a steep

[13]https://www.ato.gov.au/individuals/investments-and-assets/crypto-asset-investments/transactions---acquiring-and-disposing-of-crypto-assets/staking-rewards-and-airdrops/

learning curve to gain a foundational understanding of blockchain and crypto assets. Appropriate tax treatment requires a reasonable knowledge of a taxpayer's facts and circumstances. Some tax advisers are calling for more support from the ATO and professional associations to educate and upskill tax agents, including:

- Educational links and materials on crypto assets
- Information addressing common scenarios and associated tax treatment
- List of common issues and misconceptions
- Appropriate disclosures and checklists
- Explanations on practical record-keeping options, including software platforms and how they can be used by tax professionals
- Questionnaires to obtain relevant information from clients

Further support should be provided to tax agents to fulfil their obligations under the Tax Agent Services Act 2009 (TASA) to ensure they can confidently use software in assisting with managing compliance and data aggregation affairs whilst maintaining oversight over the technical tax treatment of crypto transactions. Accountants should not be encouraged to accept crypto tax software reports at face value without due consideration that all relevant client wallets are integrated, and the appropriate tax settings are applied.

It is recommended that tax agents are supported by clear communication from the ATO in respect of its compliance approach to uncertain matters raised as part of this consultation process. In particular, there is widespread uncertainty in relation to the tax treatment of DeFi, Staking and GameFi, which should be taken into account by the ATO to provide support to the tax adviser community. Ultimately, it is important that guidance implemented following this Board of Tax Review is enacted into legislation on a timely basis.